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Understanding key market trends in times of COVID-19

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Exploring the impact of the COVID-19 crisis on the European audiovisual sector

Discussion paper

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By mid-May 2020, the audiovisual sector is still in the midst of the COVID-19 crisis: lockdown measures are only partially alleviated (e.g. cinemas are still closed; consumption, and therefore advertising has not returned to its pre-crisis levels etc.). More generally, the audiovisual sector depends to an extent on the general economic climate, and it is unclear whether the 2020 first semester recession will be followed by a rapid recovery or will result into a long-lasting economic crisis. Any full assessment of the impact of the COVID-19 is obviously premature. The goal of this discussion paper is therefore to explore the zones of impacts of the crisis to prepare for post-COVID-19 future scenarios. It is structured in three sections:

- Reminders on the financial flows in the European audiovisual sector, to understand the interdependence between the various value-chain components.
- Reminders on the trends at work before the COVID-19 crisis.
- Initial observations on the impacts of COVID-19.

1. The financial flows in the European audiovisual sector

The following graph (on page 3) is an oversimplified representation of flows in the European audiovisual sector. It is organised under three layers:

- The end-market revenues:

The vast majority of the end-market revenues of the European audiovisual sector arise from three main sources: public funding (mostly to fund Public Service Broadcasters - PSBs), TV advertising and

subscriptions to pay-services (linear Pay-TV and Subscription Video-On-Demand). The two additional segments, i.e. cinema box-office and Home video (both physical and digital) weight significantly less.

- The exploitation revenues by category of players

Several players use a mix of revenues: PSBs are mostly funded by public funding (sometimes through a licence fee) but also by advertising; cinemas draw a substantial part of their revenues from other sources than the sale of cinema tickets etc.

- The production revenues¹ (this layer has still to be documented).

All players contribute to production. "Production" encompasses many genres:

- Films
- Audiovisual "works" (in the French meaning): audiovisual fiction, documentaries, animation etc.
- Other television genres (talk-shows, game shows etc.)
- News
- Sports

Players contribute to production either **directly** (funding or participation in the funding of **original production; acquisition** of existing programmes) or **indirectly** (contribution through levies and taxes to film funds which in turn invest in production).

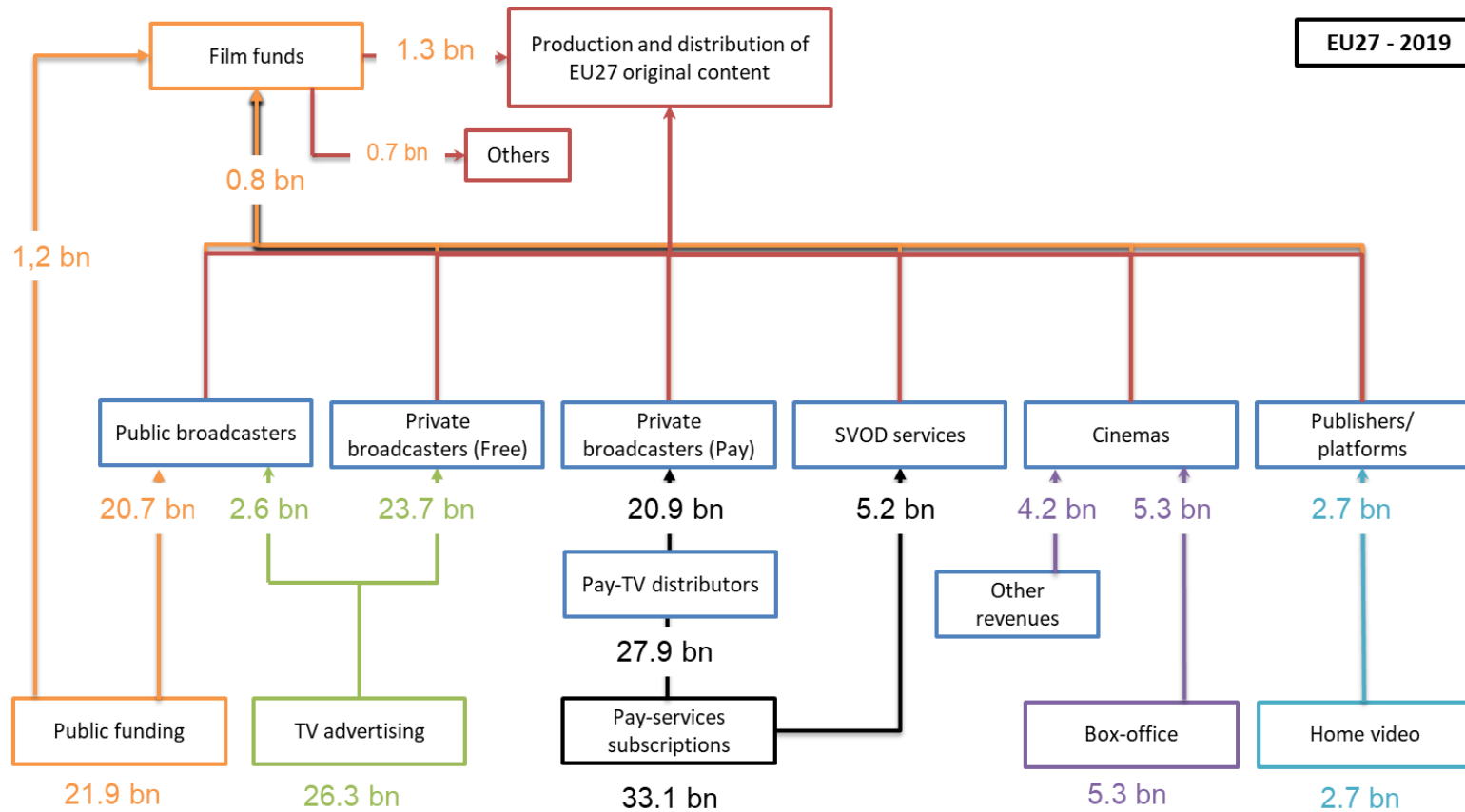
Players **contribute differently to each genre of production**: obviously, cinema revenues benefit almost exclusively to films; similarly, the vast majority of home video revenues goes to films. A free-to-air channel will spend its programming budget in all genres, with differences between private and public players. A pay-TV channel will dedicate a significant part of its resources to acquire sport programming. A SVOD service focuses its programmes spending in fiction and documentaries. Public funds mostly contribute to the funding of films².

The respective share of programming expenses in **original productions and in acquisitions** is broadly linked to the size of the player. Roughly speaking, the bigger the player, the higher the share spent in original programming.

¹ Including the distributors.

² With several exceptions: France, MEDIA, etc.

Simplified representation of financial flows in the EU audiovisual sector³



³ 2018 or 2019 data, except for film funds (2014), whose budget maybe therefore underestimated. Excludes broadcasters' "other revenues"

2. Trends at work before the COVID-19 crisis

Several trends were already at work before the COVID-19 crisis.

2.1. Stagnation of the sector's revenues

The total audiovisual resources tend to stagnate:

- **TV advertising**, although resisting better than print, is challenged by Internet advertising.
- **Linear pay-TV** is challenged by **SVOD**. Massive number of consumers migrating from Pay-TV to SVOD may have the following impacts:
 - The SVOD tariffs are lower than the linear pay-TV tariffs. In particular, SVOD tariffs may be to some extent “subsidised” to sell other products and services (e.g. mobile phones or delivery services). Therefore, a switch of subscribers from pay-TV to SVOD may have a negative impact on the total revenues.
 - The “programming mix” of SVOD services is not necessarily the same than linear pay-TV services (e.g. no sports, or more TV series and less films).
- **Public Service Broadcasters** revenues rely (at more than 85%) on public funding (or licence fees) and, to a much lesser extent on advertising. Their revenues have been on average decreasing in real terms over the past years.
- **Cinema box-office revenues** are stable, with annual fluctuations depending on individual blockbusters.
- **Home video revenues** are decreasing, as digital rental and purchase (Transactional Video-On-Demand – TVOD) do not compensate the losses of physical video.

2.2. Content production

As regards content production, even if comprehensive figures are lacking, the following trends seems at work:

- Increase in the number of films produced, but pressure on funding due to constraints on most players contributing to funding, and polarization between high-budget films and low-budget films.
- Increasing demand for high-end audiovisual fiction, boosted by the competition from new SVOD services, and need for legacy players to reallocate more resources to this genre, in particular by more coproductions between TV channels.
- Upward trend for sport rights, fuelled by new players (broadcasters but also Internet players) entering the market.

2.3. Industry structure

The industry structure has shown recent signs of evolution. The state of play before the COVID-19 crisis was the following:

- Only a few **European audiovisual services companies are active at a European level** (RTL) or at a regional level (Nent and Bonnier in Scandinavia). Other companies derive most of their revenues from their national market, even if they are active in another (e.g. Mediaset, Canal+). By definition, Public Service Broadcasters are active only in their domestic market. Some

broadcasters (e.g. Italy Mediaset and Germany ProSiebenSat.1) explore the possibilities of mergers to build European broadcasting groups. By contrast, the leading SVOD players are active globally in Europe.

- As regards **film production**, there is no European mini-major⁴. The production landscape is mainly national, with a handful of midsize players (less than 10 films per year), often also active in distribution, and a myriad of small production companies. The internationalisation of the market is therefore firstly driven by international coproductions (with often excellent results in terms of festival awards, but with national box-offices often favouring 100% national films⁵).
- The panorama is strikingly different as regards **TV (and SVOD) production**. A consolidation process is at work, in the form of production pure-players (Banijay-Endemol), or in the form of broadcasting companies (mostly private – RTL, ITV etc.- but also public – BBC) affiliated production groups working for all broadcasters.

This **consolidation of the TV production sector** is driven by three main factors:

- TV production has more characteristics of an industry than film production: investments in development can be recouped in longer TV series.
- Holding the rights of TV shows is seen by certain broadcasters as a more future-proof business model than broadcasting; the strategy is therefore to move upward the value chain.
- Large TV production groups, active in several markets, believe they can more easily raise national funding from the individual market they are present in than through traditional coproductions.

2.4. Strong national specificities

There are of course strong differences between European countries:

- **As regards audiovisual services:** weight of the Public Service Broadcasting, respective role of pay and free TV; market share of television within the advertising market; growth rates etc.
- **As regards content production:** French ecosystem exception, leading role of UK in high-end TV production, differences in the public funding approaches between cultural and industrial goals etc.

⁴ Canal+'s StudioCanal is probably the one exception. EuropaCorp was another attempt.

⁵ And, of course, US blockbusters.

3. Exploring the consequences of the COVID-19 crisis

3.1. General observations

3.1.1. Differed consequences of the lockdown period

Some structural factors are likely to differ the impact of the COVID-19 lockdown period. For instance:

- A significant part of linear pay-TV subscribers is bound by one-year contracts. Cancellation of subscriptions may therefore be postponed until the renewal date.
- Public Service Broadcasters' public resources are defined on a yearly basis. Even if short term budget cuts cannot be totally discarded, the impact of austerity measures on the PSB's budgets may only take place in 2021.
- The film funds levies and resources may be based on the previous year revenues, therefore differing by one year the impact of the COVID-19 lockdown.

As a consequence, even in the (optimistic) hypothesis of a fast "rebound" after the end of the lockdown, the COVID-19 crisis will have effects onto 2021.

3.1.2. Lessons from the past

It is likely that 2021 could see the general economy rebound, but not reaching the levels of the pre-COVID-19 crisis. The 2008-2009 crisis teaches some lessons with regard to the resilience of each segment to an economic downturn:

- TV advertising declined twice as much as GDP, as advertising expenses tend to be more easily reduced by companies than other running costs. It took about 10 years for TV advertising to recover its 2007 levels (in constant prices).
- Pay-TV saw its growth rate cut in half, but no decline in revenues. It should be noted that, at that time, few alternate solutions were available for accessing to high-end programming. It is also likely that when pay-TV is bundled with broadband access, consumers are less prone to terminate their pay-TV subscription.
- No lessons can be easily drawn for other sectors: cinemas benefitted from the outstanding success of AVATAR in 2009; the level of public funding of broadcasters varied differently depending on the countries; the decline of home video had started before the crisis.

3.1.3. Rebalancing within the sector vs. losses of resources for the sector

Competition takes place both within the audiovisual sector, but also between audiovisual and non-audiovisual players. Transfer of resources due to the COVID-19 would therefore have different consequences:

- Should the COVID-19 translate into a loss of advertising market share for broadcasters to the benefit of Internet, the corresponding revenues will be lost for the audiovisual sector, as the bulk of advertising goes to Google and Facebook which do not produce audiovisual content.

- Should the COVID-19 crisis translate into an accelerated switch from traditional pay-TV players to SVOD platforms, the corresponding revenues would still benefit the production of audiovisual content, provided that the leading platforms actually invest. But, as SVOD services are less expensive than pay-TV services, the total expenses of consumers might diminish.

3.2. The impact on end-market segments during and immediately following the lockdown

As of May 2020, two market segments seem particularly hit by the COVID-19 crisis:

- **Cinemas**, whose activities have totally stopped and whose reopening (when decided) will face many constraints: limited capacity; uncertainty on release of (US) blockbuster; absorption of films whose release was delayed etc. Whereas movie theatre multiplex chains may have the resources to resist the crisis (even if the world major cinema chain, AMC might fall for bankruptcy), smaller “art house” cinemas may be forced to cease activities.
- **TV advertising**, as the drop-down of consumption directly resulted in a fall of advertising expenditures.

The impact is unclear as regards the other segments:

- **Linear pay-TV** attractiveness relies primarily on recent films and sport. The (provisional or definitive) stop of the main sports leagues could have triggered subscription cancellation, mitigated by long-term contracts. On the other hand, linear-TV probably benefits from the additional time spent watching TV during the lockdown.
- Initial figures show that **SVOD** subscription were boosted by the lockdown (not necessarily at the expense of linear pay-TV as subscribers may have wanted to add more entertainment sources).
- **The Public Service Broadcasters** are obviously less dependent to commercial resources and are therefore, at least in the short term, more resilient to the crisis.

3.3. The impact on content production and exploitation during and immediately following the lockdown

Content production and exploitation is affected in several ways:

- **Standstill of shootings** due to the lockdown measures. As of mid-May 2020, shootings are starting again in several countries. Restarting shootings, when possible, may imply additional production costs.
- **Shortage of new content for broadcasters.** The standstill of shootings led to a shortage of original content for broadcasters. It is also likely that, in a context of declining advertising resources, broadcasters may have chosen to postpone the broadcast of original content and have favoured reruns.
- **No theatrical release for films.** The closing-down of cinemas has either interrupted the cinema exploitation of films or deprived them from any cinema exploitation. Some distributors have

opted for a direct-to-VOD release of films, other have chosen to postpone the theatrical release, with the risk of cinemas being unable to exhibit both these films and the new releases.

Unlike audiovisual services, the vast majority of **production companies** are small organisations, with scarce equity, which may not be in a position to resist the crisis, even if productions start again. Production companies rely on a vast population of **free lancers**, as regards both artistic and technical crews, whose revenues have been dramatically reduced during the crisis.

3.4. Short term mitigating measures

Governments, regulators, film agencies have taken a wide range of measures to limit the short term impact of the COVID-19 crisis (please see the tracker of COVID-19 measures of the European Audiovisual Observatory: <https://www.obs.coe.int/en/web/observatoire/covid-19-audiovisual-sector-measures>). Most of these measures are aimed at the production sector as structural measures for audiovisual services could imply changes in regulation. Cinemas also benefit from general-interest measures.

3.5. Mid-term impact of the COVID-19 crisis

As of mid-May 2020, only a series of hypotheses can be drawn regarding the impact of the COVID-19 crisis:

- **Smaller cinemas are at risk**, and the theatrical exploitation of independent art house films may become more difficult. Some analysts foresee that cinemas will focus more on the exploitation of European and US films, and that European art house films will increasingly rely on the funding of the major SVOD platforms. This trend would be aggravated by broadcasters investing less in films, and by decreasing resources from film funds.
- **TV advertising is at risk**: should Internet advertising recover better and sooner than TV advertising, the audiovisual sector will suffer a major loss of revenues. Advertising-funded broadcasters will suffer new limitations to invest in high-end TV fiction at a time when the genre is key in the competition with SVOD platforms. To mitigate this shortage in resources, broadcasters may opt to invest more in TV series and less in films.
- **Public broadcasters even more important**: PSBs already play a key role in the production of high-end content (film and TV). In the context of a TV advertising crisis hitting private broadcasters, whether austerity measures will or will not be imposed to PSBs will be key for the recovery of the sector.
- **Acceleration of cord-cutting**: the COVID-19 has probably introduced many consumers to SVOD services, who may trade-off their pay-TV subscription against a SVOD subscription as a second step.
- **High-end production threatened**: the previous risks turn in the possibility that European services cannot afford to develop their high-end productions anymore, which would result into more dependency towards US SVOD platforms.

3.6. Contrasting visions

Rather than disrupt it, the COVID-19 crisis could accelerate and amplify trends already at work in the audiovisual sector: i.e. stagnation of resources of both audiovisual services and content production and shift of market power towards US players. In this context, at least **two strategic visions** can be confronted:

- on the one hand, a **production-centric vision**: major platforms will inexorably become the dominant players in the audiovisual services landscape. The main policy objective would be therefore to ensure that the platforms contribute to European production by adapting the legal and financing ecosystem. In other words, the war is lost for European broadcasters, but can still be won for European producers.
- on the other hand, an **audiovisual services-centric vision**: relying on US-based platforms would result in losses for the audiovisual services in terms of creation of wealth and employment, that would not be compensated by the platforms, either because they are not part of the audiovisual ecosystem or because they operate mainly from outside Europe. It would also result in the loss of creative control and financial independence for European content production and ultimately affect its diversity. The main policy objective would be therefore to support Europe's key players e.g. by supporting small cinemas, improving the competitiveness of TV advertising vs. Internet advertising, fostering cooperation between broadcasters (including with a positive attitude towards mergers), protecting the windows of the legacy players etc.

Designing the post-COVID-19 crisis recovery measures for the audiovisual sector will hopefully bring a unique opportunity to clarify the policy vision or at least carefully balance its sometimes diverging objectives.